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III.E. Differentiation in East-West Economic Relations

Introduction

This paper addresses only the economic aspects of the policy of differentiation as it relates to East-West economic relations and thus is only a partial assessment. Judged solely in economic terms, the payoff to the United States has been minimal.

Background and History

The history of U.S. commercial and financial policy towards Eastern Europe reflects a certa.n tension between two goals: (1) encouraging the development of more liberal political, economic and social trends within these countries and fostering their adoption of foreign policies independent of the USSR; and (2) denying preferential treatment and assistance to countries considered to pose a threat to U.S. security interests. In seeking to achieve these objectives, U.S. policy has differentiated in favor of Hungary, Poland, and Romania but has maintained a restrictive stance towards the USSR, Bulgaria, Czechoslovakia, and the GDR.

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The economic policy tools used to implement differentiation between the treatment accorded the USSR and Eastern European countries and among the latter include: extension of Most Favored Nation (MFN) tariff treatment (by law based on reciprocity in tariff concessions, emigration performance and mutual benefit); extension of Export-Import Bank and Commodity Credit Corporation (CCC) credits (terms on such credits may be more favorable than market rates, and government lending may facilitate private bank lending by raising confidence); concessional sales of foodstuffs (Poland has received the great preponderance of such assistance); and modestly less restrictive application of export controls for some countries in comparison with treatment accorded the USSR. In general, Poland has benefitted the most and over the longest period from this differentiated approach. It gaind MFN treatment in 1960 and has enjoyed considerably more benefits from U.S. credits than Hungary and Romania.

In the early 1970s, the impetus for improving economic relations with Eastern Europe was associated to a large extent with detente and expanded ties with the USSR, rather than with differentiation per se, although differentiation was in fact practiced giving Poland and Romania more favorable treatment than either the USSR or other Eastern European nations. In 1972, the US-USSR Trade Agreement promised MFN treatment and

other economic benefits for Moscow and the Soviets gained access to Export-Import Bank credits. The Jackson-Vanik Amendment to the Trade Act of 1974, however, changed the thrust of U.S. policy by making MFN and official credits for communist countries contingent on the individual country's performance in ensuring free emigration. The USSR has failed to meet the Jackson-Vanik criteria and thus was denied MFN and, since 1974, EXIM credits.

Romania in 1975 and Hungary in 1978 were certified as eligible for MFN and official credits, and they have cleared the subsequent annual reviews. East Germany, Czechoslovakia, and Bulgaria have not yet begun the process. In the mid-1970s Poland drew heavily on EXIM credits, and $670 million in CCC credit guarantees were crucial to Poland during 1980-81 when commercial credits were not available to finance Warsaw's huge grain imports. Romania also has used EXIM and CCC credits, while Hungary, a food exporter, has drawn only a very small amount of CCC credits. With the exception of Poland, the preponderance of U.S. lending to Eastern Europe has been by private commercial banks.

Export control policy also has differentiated among bloc countries, if slightly. COCOM, the multilateral Wastern export control body, granted Poland favorable consideration from the 1950s until early this year. Unilateral U.S. export control

also favored Poland until martial law, and Romania and Hungary gained similar treatment at about the same time that they were awarded MFN. The guidelines for both COCOM and U.S. controls are identical for exports to all bloc countries, but the favored countries stand a somewhat better chance of approval.

Costs and Benefits

In embarking on a policy based on differentiation, the United States sought to improve relations with the countries of Eastern Europe on a broad range of issues as well as to reap substantial economic gains from increased trade. U.S. businessmen envisioned untapped markets in CEMA for grain, capital goods and technology, and even consumer goods. Bankers were willing to lend to facilitate the trade and to cover the East's temporary inability to export enough to pay for the imports. Western imports were expected to strengthen the Eastern economies and increase their export potential.

As a result of the improved climate for trade, U.S. trade with Eastern Europe climbed dramatically from a very low base. U.S. exports to the area increased 250 percent between 1972 and 1975, and imports rose 191 percent. Poland, Hungary, and Romania -- favored by U.S. policy -- recorded much faster growth than did the other three, even before the legal changes that liberalized economic relations. Although the trade flows have always been too small to have more than a negligible

impact on our economy, manufacturers of capital equipment and farmers welcomed the sales to the East, and the cost to the U.S. government was small and confined largely to direct CCC credits at subsidized interest rates. On economic grounds, the benefits of detente and differentiation in the first half of the 1970s did outweigh the costs since the latter were small.

Beginning in the mid-1970s, the onset of debt and absorption problems in Eastern Europe began to reduce the rate of growth of their trade with the West. The flows of Western capital goods to the East proved ineffective in producing the needed increase in East European exports. The result was a further increase in debt and debt service. Trends in U.S. trade with Eastern Europe were similarly affected, with the exception of a continued boom in sales of agricultural products as a result of several disappointing crops in Eastern Europe. U.S. trade with Romania and Hungary, for example, increased for a short period after they gained MFN and access to Export-Import Bank credits.

-- U.S. trade with Romania rose sharply between 1975 and 1980, but stagnated last year as a result of payments problems.

-- U.S. trade with Hungary recorded a modest increase after Budapest was granted these trade benefits in 1978, but also slowed in recent years. Regardless of U.S. policy, until the East European countries are able to improve their export

performance and deal effectively with their debt servicing problems, the West will not enjoy the gains from trade anticipated in the early 1970s.

In the past year, the costs to the U.S. of our past lending policies to Poland have escalated as it has been unable to service its debts. The United States has rescheduled Warsaw's direct official loans and assumed the debts to U.S. banks that carry a government guarantee. The revenues foregone and payments made in 1981 totaled $381 million; the comparable figure for 1982 could be about $640 million. Because the prospects for repayment of loans originally extended and recently assumed are questionable, the ultimate costs could be much higher. Romania also has approached the Paris Club for a rescheduling of official debt, but the United States has not yet agreed to reschedule. Romania's debt to the United States is not as large as that of Poland, and the cost to the government would be correspondingly smaller.